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August 18, 2008

AGENDA ITEM 5

TO: MEMBERS OF THE INVESTMENT POLICY SUBCOMMITTEE

- I. SUBJECT:** Policy Review and Consolidation Project – Revision of Alternative Investment Management (AIM) Policies
- II. PROGRAM:** Alternative Investment Management
- III. RECOMMENDATION:** Recommend to the Investment Committee approval of the Statement of Investment Policy for Alternative Investment Management (AIM) Program.
- IV. ANALYSIS:**

Background

The objectives of the Policy Review Project are (1) to organize and streamline Investment Policy to improve access, clarity and transparency, (2) to provide a consistent Investment Policy framework, and (3) to ensure that the policies will facilitate the on-going CalPERS compliance program.

On June 18, 2007, Investment Office staff presented to the Investment Committee the building blocks for the project. This included the revised policy template, which is designed to provide consistency across policies, and the new Table of Contents (Attachment 1), which is designed to reflect a top-down and cross-asset class organizational approach. Finally, to facilitate the top-down approach, staff presented and the Committee approved a new overarching Statement of Investment Policy for the Total Fund.

The Policy Review Project entails a detailed review of each policy with the goal of updating and streamlining the policy, as well as potential consolidation with other

related policies. In addition to these goals, the review and revisions include the following:

- Removal of delegations from policy. During the Delegations Project, staff reviewed all policies, minutes, and delegations to identify and consolidate delegations. Delegations are now located in consolidated documents.
- Removal of operational and procedural language, which is now located in staff internal procedure manuals.
- Conformance to the new template.

The review is a joint effort and includes input from the Committee's independent investment consultants, the CalPERS Legal Office, and the Enterprise Office of Compliance.

The policies are being brought forward to the Policy Subcommittee on a phased basis. To date, the Policy Subcommittee has reviewed and approved revisions to the following policy categories: Total Fund Statement of Investment Policy, Asset Allocation, Fixed Income, Global Equity, Investment and Risk Management, and Operations. The policy being presented in this item is the Alternative Investment Management policy.

PCA and Wilshire opinion letters, supporting the policy revisions for the policy presented in this item are included as Attachments 2 and 3, respectively.

A. Revision of Alternative Investment Management (AIM) Program Policy

Clean and blacklined versions of the AIM Program Policy are provided. As a general rule, the revised policy has not been changed substantively. Substantive changes that were deemed necessary at this time have been highlighted for the Subcommittee's convenience below.

One substantive change to the short term benchmark is recommended. The original short term benchmark was weighted to match the weightings of buyout, venture capital and mezzanine within the AIM portfolio. The recommendation is that the benchmark be changed to the Custom Young Fund Universe median return without making any adjustments for the weights within the AIM portfolio. This change would make the policy benchmark the same as the benchmark used in the Performance Plans approved by the Performance and Compensation Committee at their June 17, 2008 meeting.

The deletions from the policy were either definitional and are now linked to the Glossary or were operational and procedural in nature and are contained in the AIM Internal Procedures Manual.

Because the objective of the Policy Review Project was to organize and streamline Investment Policy, Staff did not make any substantive changes other than the change to the benchmark as noted above. However, in reviewing the policy Staff noted some areas that may need to be reviewed for possible substantive changes, such as possible ranges for sub-asset classes, geographic exposures, etc. The Staff and Consultant will research these areas and come back to the Subcommittee with further information and recommendations as appropriate.

The policy was edited for clarity and to conform to the new template. Staff recommends that the Policy Subcommittee approve revisions to the Alternative Investment Management (AIM) Program policy.

B. Restricting AIM Investments in Public Sector Outsourcers

At this time staff is not recommending changes to this policy. The strategic objective of this policy is to restrict private equity investments in entities that are likely to outsource U.S. state and local public sector jobs and was developed with close input from representatives of organized labor, as well as the general partner community. The form of this policy does not lend itself to conforming to the new template.

V. STRATEGIC PLAN:

This item is consistent with the Strategic Plan: Goal VIII, manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first to pay benefits and second to minimize and stabilize contributions.

VI. RESULTS/COSTS:

There are no material costs associated with this agenda item.

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